R. Gerard Salemme
Vice President - Government Affairs

Suite 1000
1120 20th Street, N.W.
Washington, DC 20036
202 457-3118
FAX 202 457-3205

July 11, 1996

Mr. William F. Caton
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

RE: Ex Parte Presentation
CC Docket No. 96-98

Dear Mr. Caton:

On July 10, 1996, per the request of Commission, the attached informative material was delivered to John Nakahata with regard to the above-captioned docket.

Due to the late hour of the request, two copies of this Notice are being submitted to the Secretary of the FCC the following business day in accordance with Section 1.1206(a)(1) of the Commission's rules

Sincerely,

R. Gerard Salemme

Attachment

cc: J. Nakahata

ANALYSIS OF OHIO AND ILLINOIS RESALE PRICING APPROACHES

INTRODUCTION

The purpose of this paper is to compare and contrast the methods for establishing wholesale prices for resold telecommunications services in Ohio and Illinois. A brief overview of the Ohio and Illinois approaches will be presented first. This will be followed by an analysis of the logic supporting each approach and an estimation of the extent to which the resultant average discounts will be comparable. The overall conclusion of this paper is that the two methods, while approaching the issue from different starting points, are logically consistent and likely to result in average discounts which are comparable.

OHIO APPROACH

The method prescribed for setting wholesale rates in Ohio is set forth in the Finding and Order in Case No. 95-845-TP-COI, a Commission investigation relative to the establishment of local exchange competition and other competitive issues. The Ohio approach has as its foundation the wholesale pricing language in the Federal Telecommunications Act. The Order specifies (by account) several categories of avoided costs which shall be identified including uncollectible revenue, marketing, product management, sales, advertising, call completion service, number services and customer service. Importantly, it also requires that the avoided cost analysis include the direct *and indirect* costs of all activities eliminated due to wholesale provisioning. The Ohio approach also provides: (1) the opportunity for resellers to prove the avoidance of costs in other accounts, and (2) the opportunity for the incumbent LEC to prove that costs identified by the Order would not be avoided and to identify direct and indirect additional costs required to provide wholesale service (such as providing an electronic operation interface to customer accounts and handling service requests of resellers).

ILLINOIS APPROACH

The method used in Illinois is outlined in the Order in Docket 95-0458/0531 (consol.), which addressed AT&T's Petition for a total local exchange wholesale service tariff. The Illinois Commission started with a long run service incremental cost ("LRSIC") study performed by Ameritech Illinois. This study addressed retail and wholesale versions of services offered for resale. The difference between the retail and wholesale results was used to identify avoided costs. These avoided costs included uncollectible revenue, marketing, product management, sales, advertising, and customer service. The study also accounted for additional costs Ameritech expects to incur in offering wholesale service. The Illinois Commission also included a pro rata share of contribution in the calculation of wholesale discounts. The result is an array of service-specific wholesale discounts, the weighted average of which Ameritech calculated to be 22.05%.

COMPARISON OF OHIO AND ILLINOIS METHODOLOGIES

The Ohio and Illinois methodologies are fundamentally consistent. Both start by identifying direct costs that will be avoided when converting to a wholesale environment. Both then proceed to account for indirect costs that will be reduced as a result of retailing activity being performed by resellers. The Ohio approach provides the opportunity for indirect costs to be specifically identified. The Illinois approach accomplishes this same result by way of the pro rata contribution calculation.

The contribution contained in the prices of Ameritech's services includes costs for assets and functions such as buildings, vehicles, furniture, office equipment, computers, personnel department, etc. The Illinois wholesale pricing approach captures a portion of these costs in the establishment of the discount percentage by including a pro rata share of contribution.

Although the Ohio and Illinois methodologies may appear on the surface to be different, they both rely on actual accounting data in a manner which makes them logically consistent. The Ohio approach utilizes accounting data directly. On the other hand, the Illinois method indirectly relates to the Company's accounting results by: (1) using accounting results as the basis for the calculation of certain direct avoided costs, and (2) basing the pro rata contribution calculation on revenues and costs as booked by the Company. The Illinois approach utilized detailed service-specific cost studies in a docket that took over nine months to complete. Alternatively, the Ohio approach is more streamlined and will allow proper wholesale discounts to be determined expeditiously. While the Illinois approach resulted in variation in the discount percentage from service to service (reflecting each service's cost and profitability characteristics), the availability of a viable competitive business opportunity is more a function of the overall average discount level than its variability among different services.

COMPARISON OF OHIO AND ILLINOIS PERCENTAGE DISCOUNTS

It is expected that the Ohio and Illinois approaches will result in discounts that are generally the same order of magnitude. The Illinois weighted average discount is 22.05%. Because this average is comprised of an array of service-specific discounts, the actual discount experienced by a particular reseller (with its own unique blend of wholesale services) could be higher or lower than this average. Furthermore, AT&T took the position in Illinois that Ameritech's cost study did not fully account for all costs that will be avoided, making a 25% discount more appropriate in its view. This 25% discount is also corroborated by an accounting-based study which AT&T included as part of its initial testimony in this docket. The Illinois Commission also expressed its intention to consider a schedule of additional incentive discounts if Ameritech Illinois and Centel are unable to comply with the parity requirement for operational interfaces.

AT&T reports that it has estimated the wholesale discount resulting from the Ohio approach. This analysis identifies the local services portion of the direct costs specified by the Ohio Order as well as a pro rata share of indirect costs. It results in a discount approaching 30%. It is possible that certain additional costs exist for providing wholesale services. Such a showing, if accepted, would put a modest downward pressure on the calculated wholesale discount. Such an outcome would still result in a wholesale discount in the same general range as Illinois. Absolute equality of the discounts is unlikely because the LEC cost structure is not identical from state to state.

CONCLUSION

Ohio and Illinois have approached the issue of wholesale pricing using slightly different, although logically consistent, methodologies. Application of these methodologies is expected to result in wholesale discounts which are the same general order of magnitude. The reasonableness of that result is supported by the convergence of these two state-specific methods and the further corroboration provided by AT&T's accounting-based study filed with its initial testimony in the Illinois resale docket.